

GAO

Report to the Chairman, Subcommittee
on Select Education, Committee on
Education and the Workforce, House of
Representatives

September 2001

FINANCIAL MANAGEMENT

Poor Internal Controls Expose Department of Education to Improper Payments



G A O

Accountability * Integrity * Reliability

Report Documentation Page

Report Date 00SEP2001	Report Type N/A	Dates Covered (from... to) -		
Title and Subtitle FINANCIAL MANAGEMENT: Poor Internal Controls Expose Department of Education to Improper Payments	Contract Number			
	Grant Number			
	Program Element Number			
Author(s)	Project Number			
	Task Number			
	Work Unit Number			
Performing Organization Name(s) and Address(es) U.S. General Accounting Office P.O. Box 37050 Washington, DC 20013	Performing Organization Report Number GAO-01-1151			
Sponsoring/Monitoring Agency Name(s) and Address(es)	Sponsor/Monitor's Acronym(s)			
	Sponsor/Monitor's Report Number(s)			
Distribution/Availability Statement Approved for public release, distribution unlimited				
Supplementary Notes				
Abstract <p>On July 24, 2001, we testified before your subcommittee on our ongoing review of the Department of Education's payment processes and how the existing internal control weaknesses we have noted thus far make the department vulnerable to, and in some cases have resulted in, improper payments. 1 This letter briefly summarizes our testimony and formalizes specific recommendations made to the Secretary of Education in our testimony. We performed our work from August 2000 through July 2001, in accordance with generally accepted government auditing standards as well as with investigative standards established by the President's Council on Integrity and Efficiency. Further details on our objectives, scope, and methodology are included in appendix I. Our testimony, which includes our detailed findings, is reprinted in appendix II.</p>				
Subject Terms				
Report Classification unclassified	Classification of this page unclassified			
Classification of Abstract unclassified	Limitation of Abstract SAR			

Number of Pages

28



United States General Accounting Office
Washington, DC 20548

September 28, 2001

The Honorable Pete Hoekstra
Chairman
Subcommittee on Select Education
Committee on Education and the Workforce
House of Representatives

Dear Mr. Chairman:

On July 24, 2001, we testified before your subcommittee on our ongoing review of the Department of Education's payment processes and how the existing internal control weaknesses we have noted thus far make the department vulnerable to, and in some cases have resulted in, improper payments.¹ This letter briefly summarizes our testimony and formalizes specific recommendations made to the Secretary of Education in our testimony. We performed our work from August 2000 through July 2001, in accordance with generally accepted government auditing standards as well as with investigative standards established by the President's Council on Integrity and Efficiency. Further details on our objectives, scope, and methodology are included in appendix I. Our testimony, which includes our detailed findings, is reprinted in appendix II.

Summary of the Testimony

Our work has focused on three types of disbursements made from May 1998 through September 2000—grants and loans totaling \$181.4 billion, third party drafts totaling \$55 million, and government purchase card transactions totaling \$22 million. The results of our work thus far in each of these areas is summarized below.

In the grant and loan area, we found that certain edit checks and other key controls were missing from Education's payment system. For example, Education's student aid application processing system lacked an automated edit check that would identify students that were much older than expected. Following up on our tests that identified schools with

¹ *Financial Management: Poor Internal Control Exposes Department of Education to Improper Payments* ([GAO-01-997T](#), July 24, 2001).

unusual concentrations of older students, our Office of Special Investigations, in coordination with Education's Inspector General, identified four schools that disbursed as much as \$3.4 million in Pell Grants to ineligible students. These students were ineligible because they were not participating in a degree program or determined to need English language instruction in order to utilize their existing knowledge and skills. Rather, these students were primarily studying English as a second language. The investigation disclosed that at least one of the schools generated fraudulent student admissions documents to create the appearance that students were participating in a degree program. We and the department have identified a number of other schools with similar disbursement patterns that warrant further investigation. However, the department currently does not have a systematic approach for identifying and following up on unusual disbursement patterns of this nature.

During our analysis of Education's third party draft payment process, we identified several internal control weaknesses that made this process susceptible to improper payments. For example, we found 268 instances totaling about \$8.9 million where Education employees circumvented a key systems application control designed to avoid duplicate payments. Education officials are researching and providing supporting documentation for these transactions, which we will then test to determine if duplicate or over payments have actually occurred. In response to a letter from the subcommittee following the earlier April 3, 2001, hearing the subcommittee held related to our ongoing review,² the department acted to eliminate the use of these third party drafts.

While analyzing Education's use of government purchase cards, we also found several internal control weaknesses, including serious deficiencies in the department's process for reviewing and approving purchase card transactions. Over one-third of the 903 purchase cardholders' monthly statements we reviewed lacked proper review and approval for payment.

In at least two instances, we noted that these internal control weaknesses precluded Education from detecting the improper use of purchase cards. In one case, we found that a cardholder made several purchases from two pornographic Internet sites and, in another case, we found that an employee used the card to pay for a training course totally unrelated to the

² *Financial Management: Internal Control Weaknesses Leave Department of Education Vulnerable to Improper Payments* (GAO-01-585T, April 3, 2001).

activities of the department. Proper supervisory review and approval of these transactions should have identified them as improper payments. In addition, Education is not using management reports available from its contractor for government purchase cards to monitor purchases nor is it blocking Merchant Category Codes (MCCs)³ to reduce the possibility of cardholders purchasing from inappropriate vendors.

We also found that some employees may have been splitting purchases into multiple transactions to circumvent the department's limits on individual purchases. The department is currently researching a list of 124 instances totaling about \$600,000 where this circumvention of control may have exposed it to improper payments.

Also in response to your letter from the subcommittee following the April 2, 2001, hearing, the department acted to reduce the number of purchase cards held by employees and lowered the maximum monthly spending limits on the remaining cards. However, these actions do not address the issue of split purchases or the lax approval process.

Conclusions

It is critical that Education management give top priority to improving internal control to minimize the agency's vulnerability to improper payments. The Secretary's actions to respond to issues related to using third party drafts and purchase cards are important first steps. At the same time, there are other important steps that need to be taken to minimize the department's exposure to improper Pell Grants and purchase card disbursements.

Recommendations

The following are our recommendations thus far to address the key findings that are discussed in our testimony. We may have additional recommendations after we complete our work later this fall.

To help ensure that Pell Grants are not disbursed to ineligible students and to reduce the likelihood that improper purchases are made with government purchase cards, we recommend that the Secretary of Education:

³ The MCC relates to the types of supplies or services that a vendor provides. The MCC for the Government Purchase Card consists of 11 retail categories. Agencies have the ability to prohibit cardholders from purchasing certain supplies or services by blocking specific MCCs.

-
- Establish appropriate edit checks to identify unusual grant and loan disbursement patterns.
 - Design and implement a formal, routine process to investigate unusual disbursement patterns identified by the edit checks.
 - Reiterate to all employees established policies regarding the appropriate use of government purchase cards.
 - Strengthen the process of reviewing and approving purchase card transactions, focusing on identifying split purchases and other inappropriate transactions.
 - Expand the use of MCCs to block transactions with certain vendors.

Agency Comments and Our Evaluation

In oral comments on a draft of this report, Education's officials agreed with our findings, conclusions, and recommendations.

As we arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its date. At that time, we will send copies to the Ranking Minority Member of your subcommittee, the Secretary of Education, and other interested parties. We will make copies available to others upon request.

Please contact me at (202) 512-9508 if you or your staff have any questions on this report. I can also be reached by e-mail at calboml@gao.gov. Key contributors to this assignment are acknowledged at the conclusion of our testimony.

Sincerely yours,



Linda M. Calbom
Director
Financial Management and Assurance

Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) identify Education's payment processes, (2) determine what internal controls existed over these processes, (3) assess whether the internal controls were designed to provide reasonable assurance that improper payments would not occur or would be detected in the normal course of business, (4) identify additional controls that should be implemented to provide reasonable assurance that improper payments will not occur, and (5) use various computer auditing techniques to identify potential improper payments made by Education during the period May 1998 through September 2000.

To identify Education's payment processes and determine what internal controls existed over these disbursements as well as to assess whether the internal controls were designed to provide reasonable assurance that improper payments would not occur or would be identified promptly, we interviewed officials and staff in the various offices of Education, reviewed Education's policies, and performed walk-throughs of the various disbursement processes.

To identify potential and actual improper payments, we developed various computerized auditing techniques, referred to as "forensic auditing" techniques, which identified data anomalies that could be indicative of improper payments. These techniques included database searches, file comparisons, computer matches, and various other analyses to identify unusual transactions and unusual payment patterns. Using this approach, we identified questionable payments – for example, payments to closed schools or to older students not expected to be enrolled in a degree program. We then reviewed additional supporting data provided by Education that was intended to support the propriety of these payments. As necessary, our Office of Special Investigations investigated selected potential improper payments that appeared to be fraudulent to further assess their propriety. Based on the results of these investigations, instances of improper payments were referred to the Department of Education Inspector General for appropriate action.

Based on our analysis of the additional supporting data provided by Education for the potential improper payments we identified, we further assessed the existing internal control structure to identify additional internal controls that, if implemented, would have prevented these payments. We also met with department officials to discuss these additional controls and to obtain their views.

We requested comments from the Secretary of Education or his designee on a draft of this report. We obtained oral comments from cognizant Education officials who generally concurred with our findings, conclusions and recommendations. We performed our work from August 2000 through July 2001, in accordance with generally accepted government auditing standards as well as with investigative standards established by the President's Council on Integrity and Efficiency.

Appendix II: GAO's July 24, 2001, Testimony

GAO

United States General Accounting Office

Testimony

Before the Subcommittee on Select Education,
Committee on Education and Workforce, House of
Representatives

For Release on Delivery
Expected at
9:30 a.m.
Tuesday,
July 24, 2001

FINANCIAL MANAGEMENT

Poor Internal Control Exposes Department of Education to Improper Payments

Statement of Linda Calbom
Director, Financial Management and Assurance



G A O

Accountability * Integrity * Reliability

GAO-01-997T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our ongoing review of the Department of Education's payment processes and how the existing internal control weaknesses we have noted thus far make the Department vulnerable to, and in some cases have resulted in, improper payments. Improper payments include errors, such as duplicate payments and calculation errors; payments for unsupported or inadequately supported claims; payments for services not rendered or to ineligible beneficiaries; and payments resulting from fraud and abuse.

Internal control and financial management weaknesses at Education are not new. We and Education's Office of Inspector General (IG) have provided many reports and testimonies over the last several years on the financial management challenges faced by Education and the need to eliminate internal control weaknesses to reduce the potential for fraud, waste, and mismanagement at the Department.¹ In addition, since 1990 we have designated Education's student financial assistance programs as

¹ *Financial Management: Education Faces Challenges in Achieving Financial Management Reform* (GAO/T-AIMD-00-106, March 1, 2000), *Financial Management: Education's Financial Management Problems Persist* (GAO/T-AIMD-00-180, May 24, 2000), *Financial Management: Financial Management Challenges Remain at the Department of Education* (GAO/T-00-AIMD-00-323, September 19, 2000), *Financial Management: Internal Control Weaknesses Leave Department of Education Vulnerable to Improper Payments* (GAO-01-585T, April 3, 2001), and *Financial Management: Review of Education's Grantback Account* (GAO/AIMD-00-228, August 18, 2000).

"high-risk,"² largely because of severe internal control weaknesses within those programs. Further, Education's IG reported information system general controls as a material weakness in fiscal year 2000.³ The effectiveness of general controls is a significant factor in the effectiveness of application controls.⁴ Without effective general controls, application controls may be rendered ineffective by circumvention or modification.

As you know, internal controls serve as the first line of defense in safeguarding assets and in preventing and detecting fraud, abuse, and errors. It is incumbent upon Federal agency managers to establish a system of internal control consistent with our *Standards for Internal Control in the Federal Government*.⁵ Given the billions of dollars in payments made by Education each year and the risk of erroneous or fraudulent payments making their way through Education's processes

² *Major Management Challenges and Program Risks: Department of Education* (GAO-01-245, January 2001) and *High-Risk Series: An Update* (GAO-01-263, January 2001).

³ General controls affect the overall effectiveness and security of computer operations as opposed to being unique to any specific computer application. They include security management; operating procedures; software security features; and physical protection designed to ensure that access to data and programs is appropriately restricted, only authorized changes are made to computer programs, computer security duties are segregated, and backup and recovery plans are adequate to ensure continuity of essential operations.

⁴ Application controls help ensure that transactions completed through computer applications are valid, properly authorized, and completely and accurately processed and reported. Application controls include (1) programmed control techniques, such as automated edits, and (2) manual follow-up of computer-generated reports, such as reviews of reports identifying rejected or unusual items.

⁵ *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-213.1), which was prepared to fulfill our statutory requirement under the Federal Managers' Financial Integrity Act, provides an overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

without prevention or detection, you requested that we audit selected Department accounts that may be particularly susceptible to improper payments.

In response to your request, we initiated a body of work designed to (1) identify Education's payment processes, (2) determine what internal controls exist over these processes, (3) assess whether the internal controls provide reasonable assurance that improper payments will not occur or will be detected in the normal course of business, (4) identify additional controls that should be implemented to provide reasonable assurance that improper payments will not occur, and (5) use various computer auditing techniques to identify potentially improper payments made by Education during the period May 1998 through September 2000.

Our review has focused on the \$181.5 billion of disbursements that the Department made from May 1998 through September 2000. This amount includes \$181.4 billion in grant and loan payments processed through Education's Grant Administration and Payment System (GAPS), \$55 million paid by paper checks called third party drafts, and \$22 million in government purchase card purchases. We conducted our work from August 2000 through July 2001, in accordance with generally accepted government auditing standards and investigative standards established by the President's Council on Integrity and Efficiency.

On April 3, 2001, we testified at a hearing held by this subcommittee on our assessment of the internal control over Education's payment processes and the associated risks for improper payments.⁶ Specifically, we described four broad categories of internal control weaknesses (1) poor segregation of duties; (2) lack of supervisory review; (3) inadequate audit trails;⁷ and (4) inadequate computer systems' application controls. Following this hearing, the Department established a management improvement team, consisting of eight senior managers, to address the Department's serious management problems.

Since the April 3 hearing, we have focused our work on searching for potentially improper payments resulting from these and one additional internal control weakness we recently identified – transactions that were authorized and executed by persons acting outside the scope of their authority. In my testimony today I will discuss how these weaknesses make Education susceptible to improper payments in each of the major disbursement areas we have reviewed. I will also discuss several confirmed incidence of improper payments identified by our work thus

⁶ *Financial Management: Internal Control Weaknesses Leave Department of Education Vulnerable to Improper Payments* (GAO-01-588T, April 3, 2001)

⁷ Sound internal controls also include creating and maintaining adequate documentation providing a means to trace transactions back to their origination – in other words, generating "audit trails." While audit trails are essential to auditors and system evaluators, they are also necessary for day-to-day operation of the system because they allow for the detection and systematic correction of errors that arise. The Joint Financial Management Improvement Program's *Core Financial System Requirements* state that federal financial systems must provide certain crucial audit trails, including trails to identify document input, change, approval, and deletions by the originator.

Grant and Loan

Payments Lacked

Certain Edit Checks

and Other Key

Controls

far. Further, I will discuss throughout my testimony the various steps Education has taken to improve the agency's overall control environment and its efforts to research the potentially improper payments that we have identified. I will now provide a summary of our findings thus far in each of the three major disbursement areas.

Education disburses grant and loan payments by electronic funds transfer and processes these payments in GAPS. This disbursement process relies extensively on various computer systems application controls, or edit checks, to help ensure the propriety of these payments. Because these edit checks are important to the Department's controls over grant and loan payments, we focused our work on assessing whether existing edit checks were working effectively and whether additional edit checks and controls are needed.

Using computerized matching techniques, we tested the \$181.4 billion of grant and loan payments processed through GAPS to identify potentially improper payments that could have resulted from either ineffective edit checks or the lack of necessary edit checks. Following are examples of improper and potentially improper payments we identified through our various tests.

We found that Education's student aid application processing system lacks an automated edit check that would identify students that were much

older than expected. To identify improper payments that may have resulted from the absence of this edit check, we initially identified institutions that disbursed Pell Grants over multiple years to students 70 years of age or older. We chose to test for students of this age because we did not expect large numbers of older students to be enrolled in a degree program and thus eligible for student aid.

Based on the initial results of our test of students 70 years of age or older and because of the problems we identified in the past, we decided to expand our review of schools that had disproportionately high numbers of older students to include recipients 50 years of age or older. Our Office of Special Investigations, in coordination with Education's IG, investigated four schools that disbursed as much as \$3.4 million in Pell Grants to ineligible students. These students were ineligible because their primary course of study was English as a second language, and they were not seeking a degree or determined to need English language instruction in order to utilize their existing knowledge and skills. The investigation disclosed that at least one of the schools generated fraudulent student admissions documents to create the appearance that students who were not in fact seeking a degree were participating in a degree program. We previously investigated two of these four schools in 1993 and found the similar activities, including the falsification of student records to support

the schools' eligibility to participate in the Pell Grant program.⁸ We have also identified three other schools that disbursed about \$500,000 in Pell Grants that warrant additional review. These schools have unusually high concentrations of older, foreign-born students who are more likely to be studying English as a second language. We will formally refer the information related to these three schools, as well as the results of our investigations of the four schools discussed above, to Education's IG for appropriate follow-up.

During our testing, we also identified an additional 708 schools that disbursed Pell Grants to students 70 years or older totaling \$4.5 million. We provided lists of these schools to the Department for additional analysis. Based on its analysis, Education has determined that two of these schools also exhibited disbursement patterns similar to the schools above that disbursed Pell Grants to ineligible students for the study of English as a second language. For these two schools, the Department plans to perform full program reviews later this year to assess their eligibility to continue to participate in the Pell Grant program. We are currently expanding our review in this area to determine whether additional schools may be inappropriately disbursing Pell Grants.

⁸*Student Financial Aid Programs: Pell Grant Program Abuse* (GAO/T-OSI-04-8, October 27, 1993).

Education told us that they have performed ad hoc reviews in the past to identify Pell Grants disbursed to ineligible students and have recovered some improper payments as a result of these reviews. Based on the results of our analyses, Education has decided to implement a new edit check for students' 85 years or older beginning with the 2002–2003 academic year. If the birth date on a student's application indicates the student is 85 years of age or older, the application processing system will identify the applicant and Education will forward the information to the school for follow-up. Education also said it conducts other limited procedures – including the use of Single Audit results – to assess schools' determination of student eligibility. However, these procedures are not specifically designed to identify schools that are knowingly disbursing Pell Grants to students who are not eligible to participate in the program.

Regarding the edit check that Education plans to implement in the 2002 – 2003, we believe the age limit is too high and will exclude many potential problems. Using Education's criteria, we would have identified less than 1 percent of the students that were ineligible to receive as much as \$3.4 million in Pell Grants. Further, given the recurring nature of improper Pell Grant disbursements, we feel it is incumbent upon Education to implement a formal, routine process to identify and investigate questionable disbursement patterns such as those I have discussed.

Another key control, which was not in effect during the time of our review, was a match of student social security numbers (SSN) with Social Security Administration (SSA) death files. As a result, we had SSA compare loan and grant recipient data in Education's systems with SSA's death records. SSA identified over 900 instances, totaling \$2.7 million, in which the student SSN was listed in SSA's death records. We are currently in the process of reviewing additional data from Education that they believe supports the propriety of many of these payments. Beginning with the 2000-2001 award year (subsequent to our review period), as part of the application process, Education started matching student SSNs with SSA death records to identify potentially improper payments.

We also performed several additional tests of Education's existing edit checks to identify potentially improper grant and loan payments that may not have been detected by these checks. These tests included searches for a single SSN associated with two or more dates of birth, grants to recipients in excess of statutory limits, and searches for invalid SSNs. Based on these tests, we initially identified \$43.6 million in potentially improper payments, for which Education has to date been able to provide sufficient supporting documentation for \$18.7 million or about 42 percent of these payments.⁹ Education is in the process of researching the

⁹ Many of these potentially improper payments resulted from erroneous data in Education's system that was subsequently corrected.

Third Party Draft

Process Lacked

Preventive and

Detective Controls

remaining \$24.9 million of potentially improper payments. Our conclusion as to the effectiveness of Education's existing edit checks will depend on the resolution of the remaining \$24.9 million currently being researched by the Department.

Education's third party draft¹⁰ system was originally set up to efficiently process checks to pay non-Education employees who review grant applications, known as field readers. However, in May 1999, Education's policy manual expanded the use of third party drafts to pay for other expenses including employee local travel reimbursements, fuel and maintenance for government vehicles, and other small purchases. Third party drafts could be issued for up to \$10,000 - the limitation printed on the face of each draft. Executive Officers¹¹ determine who has signature authority within their units. From May 1998 through September 2000, Education's payments by third party draft totaled \$55 million. During our analysis of the third party draft payment process, we identified several internal control weaknesses, including inadequate computer systems application controls, poor segregation of duties, and inadequate audit trails. Specifically, as we discussed in our April 3, 2001, testimony, Education (1) circumvented a system's application control designed to

¹⁰ Third party drafts are a form of payment similar to a personal check.

avoid duplicate payments by adding a suffix to the invoice/voucher number when the system indicates that an invoice/voucher number has already been used; (2) allowed 21 of the 49 Education employees who could issue third party drafts to do so without involving anyone else; and (3) lacked adequate audit trails, such as a trigger log, to identify changes made to the list of approved vendors. Based on these weaknesses and information gathered from Education IG reports, we designed tests to identify potentially improper payments in this area. These tests included various automated searches of Education's disbursement data, as well as manual reviews of about 38,000 third party draft transactions.

Based on these analyses thus far, we have identified 268 instances in which multiple third party drafts were issued to the same payee with the same invoice number or on the same day, totaling about \$8.9 million. Education officials are in the process of researching and providing supporting documentation for these transactions, which we will then test for overpayments and duplicate payments.

In addition to analyzing the support for the potentially improper payments I have described, we plan to perform various computerized sorts and searches to identify additional anomalies, including a thorough review of third party drafts issued by individuals with complete control over the

¹¹ Executive Officers have the day-to-day general responsibility for financial management and maintaining funds control for the programs and activities of each of the major organizational units within Education.

payment process to determine whether questionable transactions occurred that require additional research to assess their propriety. Following the April 3, 2001 hearing, Education took action to eliminate the use of third party drafts. The Department's Third Party Draft Program's Closing Procedures, issued in May, 2001, indicates that Treasury payments will replace third party drafts. In addition, Education officials acknowledged that the Department lacks adequate trigger logs and told us that they are currently developing and implementing more-effective trigger logs. Even though Education is no longer issuing third party drafts, this is an important improvement because the same system that produced those payments also produces Treasury payments, which are replacing third party drafts.

Government Purchase Card Process Lacked Preventive and Detective Controls

Government purchase cards are available to federal agencies under a General Services Administration (GSA) contract and, according to instructions from the Department of Treasury, should generally be used for small purchases up to \$25,000. Treasury requires agencies to establish approved uses and limitations on the types of purchases and dollar amounts. According to a departmental directive, Education's policy is to use government purchase cards for authorized purchases of expendable goods and services, such as supplies not available from the GSA Customer Supply Center. From May 1998 through September 2000, the time frame

for our review, Education's payments by government purchase card totaled over \$22 million.

During our analysis of the purchase card payment process, we identified internal control weaknesses, including inadequate computer systems application controls, lack of supervisory review, and improper authorization of transactions. Specifically, we found that Education (1) did not use management reports available from Bank of America, Education's contractor for government purchase cards, to monitor purchases; (2) had serious deficiencies in its process for reviewing and approving purchase card transactions; and (3) allowed employees to execute transactions beyond the scope of their authority. Inadequate control over these expenditures, combined with the inherent risk of fraud and abuse associated with purchase card purchases, provides Education employees the opportunity to make unauthorized purchases without detection.

Based on these weaknesses and information gathered from Education IG reports, we designed tests to identify potentially improper payments made with government purchase cards. As with third party drafts, we performed various automated searches of purchase card disbursement data. Specifically, we sorted the data by principal office, cardholder, vendor,

and Merchant Category Code (MCC)¹² to identify unusual transactions and patterns. We supplemented these computerized searches with manual reviews of the over 35,000 purchase card transactions. We also selected 5 months of cardholders' statements, a total of 903 statements, to review for certain attributes, including approving official's signature.

Out of the 903 purchase cardholders' monthly statements totaling \$4 million that we reviewed, 338 statements, totaling about \$1.8 million, were not properly approved.¹³ Because this key control—supervisory review and approval—was not operating, we requested supporting documentation for these transactions from the Department. Education has provided invoices and other support related to most of the transactions included in these monthly statements. The Department believes this support will validate these transactions. We are currently reviewing the support to confirm this assessment.

We provided Education with an additional 833 transactions, totaling about \$362,000, in which the payee appeared to be an unusual vendor to be engaging in commerce with the Department. For example, we found one

¹² The MCC relates to the types of supplies or services that a vendor provides. The MCC for the Government Purchase Card consists of 11 retail categories. Agencies have the ability to prohibit cardholders from purchasing certain supplies or services by blocking specific MCCs.

¹³ The Department of Defense (DOD) issued a Fraud Alert in June 2000 indicating that government purchase card use is increasing and that along with the increase in spending levels there has been an increase in card abuse. DOD has identified several instances involving the fraudulent use of government purchase cards, some the result of supervisors who may have been negligent in their review of purchases.

instance, that is now being investigated by our Office of Special Investigations, in which a cardholder made several purchases from two pornographic Internet sites. The names of these sites should have aroused suspicions when they appeared on the employee's monthly credit card bill. We also found another instance in which Education paid for an employee to take a training course completely unrelated to activities of the Department. In addition, we gave Education a list of 124 instances, totaling about \$600,000, in which it appears that cardholders may have split their purchases into multiple transactions to bypass pre-established single-purchase spending limits. Education is currently researching these transactions.

In our April 2001 testimony, we also reported that individual cardholders' monthly purchase limits were as high as \$300,000. Education, in response to a letter from this subcommittee dated April 19, 2001, said the Department has taken action to improve internal controls related to the use of the government purchase card. Education has lowered the maximum monthly spending limit to \$30,000, revoked some purchase cards, and lowered other cardholders' single purchase and total monthly purchase limits. While these are important improvements, they will not prevent cardholders from continuing to split large purchases in order to circumvent single purchase limits. In addition, they do not address the issue of lax approval practices.

To address these issues, Education needs to reiterate and strengthen its policy of requiring review and approval of cardholders' monthly statements, including a review for potentially split purchases. In addition, Education should institute a mechanism to periodically monitor purchase card activity to ensure that proper review and approval is occurring and that split purchases are not. Further, since MCCs can be effectively used to prevent purchases from certain types of vendors, Education should expand its list of MCCs that are being blocked to further help prevent improper payments.

Conclusions and

Recommendations

In closing, Mr. Chairman, I want to emphasize the importance of Education management's giving top priority to improving internal control to minimize the agency's vulnerability to improper payments. The Secretary's actions to establish a management improvement team to address the Department's serious management problems, and to respond to issues related to using third party drafts and purchase cards, are important first steps. However, there are other important steps that we recommend be taken to address the Department's control problems. The Department needs to (1) establish appropriate edit checks to identify unusual grant and loan disbursement patterns, (2) implement a formal routine process to investigate unusual disbursement patterns identified by the edit checks, (3) reiterate to all employees established policies regarding the appropriate use of purchase cards, (4) strengthen the

process of reviewing and approving purchase card transactions, focusing on identifying split purchases and other inappropriate transactions, and (5) expand the use of MCCs to block transactions with certain vendors. Further, the Department needs to continue to focus on researching and resolving the potential improper payments that we have identified thus far. This will help provide a clear picture of any fraud or abuse that has occurred. Once the improper activities are identified, immediate action can be taken to terminate them. We discussed our recommendations with Department officials and they generally concurred. We may have additional recommendations after we complete our work later this fall.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other Members of the Subcommittee may have.

Contact and Acknowledgments

For information about this statement, please contact Linda Calbom, Director, Financial Management and Assurance, at (202) 512-9508 or at calboml@gao.gov. Individuals making key contributions to this statement include Dan Blair, Don Campbell, Anh Dang, Bonnie Derby, David Engstrom, Bill Hamel, Kelly Lehr, Sharon Loftin, Bridgette Lennon, Diane Morris, Andy O'Connell, Russell Rowe, Peggy Smith, Brooke Whittaker, and Doris Yanger.

(190024)

Ordering Information

The first copy of each GAO report is free. Additional copies of reports are \$2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are also accepted.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

Orders by visiting:

Room 1100
700 4th St., NW (corner of 4th and G Sts. NW)
Washington, DC 20013

Orders by phone:

(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet

For information on how to access GAO reports on the Internet, send an e-mail message with "info" in the body to:

Info@www.gao.gov

or visit GAO's World Wide Web home page at:

<http://www.gao.gov>

To Report Fraud, Waste, and Abuse in Federal Programs

Contact one:

- Web site: <http://www.gao.gov/fraudnet/fraudnet.htm>
- E-mail: fraudnet@gao.gov
- 1-800-424-5454 (automated answering system)